United States Court of Appeals

for the Second Circuit

PETITION FOR REHEARING

74-2542

B

United States Court of Appeals
FOR THE SECOND CIRCUIT

Docket Nos. 74-2542, 75-7003

CHRIS-CRAFT INDUSTRIES, INC.,
Plaintiff-Appellant-Cross-Appellee,
—against—
PIPER AIRCRAFT CORPORATION, HOWARD PIPER, THOMAS F. PIPER, WILLIAM T. PIPER, JR., BANGOR PUNTA CORPORATION, NICOLAS M. SALGO, DAVID W. WALLACE and THE FIRST BOSTON CORPORATION,
Defendants-Appellees-Cross-Appellants.

Appeal from Final Judgment of the United States District Court for the Southern District of New York

PETITION FOR REHEARING AND SUGGESTION FOR REHEARING IN BANC OF THE FIRST BOSTON CORPORATION

SULLIVAN & CROMWELL
Attorneys for
The First Boston Corporation
48 Wall Street
New York, New York 10005
(212) 952-8100

ARTHUR H. DEAN
DAVID W. PECK
JOHN F. ARNING
CHARLES W. SULLIVAN
Of Counsel

LOUIS LOSS
Of Counsel

April 25, 1975

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket Nos. 74-2542, 75-7003

CHRIS-CRAFT INDUSTRIES, INC.,
Plaintiff-Appellant-Cross-Appellee,

—against—

PIPER AIRCRAFT CORPORATION, HOWARD PIPER, THOMAS F. PIPER, WILLIAM T. PIPER, JR., BANGOR PUNTA CORPORATION, NICOLAS M. SALGO, DAVID W. WALLACE and THE FIRST BOSTON CORPORATION,
Defendants-Appellees-Cross-Appellants.

PETITION FOR REHEARING

Pursuant to Rules 35 and 40 of the Federal Rules of Appellate Procedure, The First Boston Corporation ("First Boston") petitions this Court for rehearing of the decision of a panel thereof (Timbers, Mansfield and Oakes, JJ.) rendered April 11, 1975, and because of the exceptional importance of the issues presented suggests rehearing in banc.

The decision on which rehearing is sought reversed the finding of the District Court (Pollack, D.J.) that the plaintiff, Chris-Craft Industries, Inc. ("CCI") had suffered damages of $1,673,988 plus pre-judgment interest of $599,010.89, and substituted a determination that CCI should be awarded damages against all defendants, jointly and severally, of $25,793,365 plus pre-judgment interest in an amount to be determined under a formula by which the total judgment will approach $35,000,000.

Liability on the part of First Boston is predicated on prior determinations by this Court (Timbers, Mansfield and Gurfein, JJ.), *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corporation,* 480 F.2d at 369 and 403 ("Chris-Craft II"), reversing contrary decisions by the District Court, that (a) Section 11 of the Securities Act of 1933, as amended (the "1933 Act") imposed on First Boston in its capacity as the dealer-manager of an exchange offer by Bangor Punta Corporation ("BPC") for the stock of Piper Aircraft Corporation ("Piper") a duty of diligent investigation, (b) First Boston failed adequately to perform the duty so imposed, and (c) by reason of Section 14(e) of the Securities Exchange Act of 1934 (the "1934 Act") First Boston's duty ran not only to the public investors who purchased the securities covered by the registration statement but also to CCI, which was engaged in a competing exchange offer and which did not purchase any of such securities.

REASONS FOR GRANTING REHEARING

A. First Boston's Unique Position Among the Defendants.

First Boston has been since its separation from First National Bank of Boston following enactment of the Glass-Steagall Act in 1934 a publicly-owned corporation and one of the leading investment banking firms in the United States. As a dealer-manager, First Boston had no interest as a principal in any of the transactions involved in this action and has never had any beneficial interest in any of the Piper shares which constitute the prize in the struggle. Its fee for acting as dealer-manager was $40,000.

This Court has now directed the entry of a joint judgment approaching $35 million against First Boston, and since it appears that indemnification or even fair contribution may not be recoverable from the other defendants, substantially the entire amount may have to be borne by it. The amount for which First Boston is thus held liable is 875 times the $40,000 fee it received for acting as dealer-

manager of the challenged exchange offer and more than four times the maximum aggregate value of the securities exchanged on the offer.

In enacting the amendments to the 1933 Act which were adopted with the 1934 Act (herein sometimes referred to together as the securities laws*) Congress recognized the important function of the investment banking industry in the capital formation process, an industry consisting of a large number of firms, each having capital too small to bear the burden of the unlimited liability for rescission damages imposed by the 1933 Act as originally adopted.

In adopting the 1934 Act amendments, Congress balanced the competing interests in protecting the investing public without destroying the investment banking industry by adding to Section 11(e) two vital limitations on such liability. The first eliminated any diminution in value not "resulting from" the violation charged. The second limited the liability of the "underwriter," as defined, to the "total price at which the securities underwritten by him and distributed to the public were offered to the public."

Summing up the views of his colleagues, Senator Fletcher, the Chairman of the Banking and Currency Committee, characterized the amendment to Section 11(e), which provided these limitations, as "the most important of all" the revisions to the 1933 Act. 78 Cong. Rec. 8185 (May 7, 1934).

The Court in Chris-Craft II held that, in order to advance the salutary purposes of the securities laws, CCI should be given standing under Section 14(e) of the

---

* It is established that the securities laws should be read and applied together as part of a single pattern of regulation. *SEC* v. *North American Research and Development Corp.*, 424 F.2d 63, 81-82 (2d Cir. 1970); *Stewart* v. *Bennett*, 359 F.Supp. 878, 882, 884 (D. Mass. 1973).

1934 Act to enforce First Boston's duty as an underwriter under Section 11 of the 1933 Act.*

The effect of Section 11(e) on the damages to be awarded against First Boston was not argued and hence may have been overlooked by the Court because the amount of damages fixed by the trial court was well below the limits fixed by Section 11(e).

The opinion simply states, without discussion, that liability is joint and several, but the Court surely did not intend, nor could it properly have intended, to confer upon CCI rights to recover against First Boston *exceeding* the rights of the public shareholders who are the express statutory beneficiaries of First Boston's underwriting responsibilities. No warrant exists in Congressional policy for such an anomalous construction of the statutory law, and the baneful effect on the investment banking industry of the exposure of investment banking firms to open-ended liability such as that imposed by the instant decision cannot be overstated.

In view of the importance of the impact of the instant decision on the investment banking industry and the failure of the Court to address itself to the effect of Section 11(e), the full Court should receive briefs and hear argument as to possible alternatives which would give effect to the intent of Congress in adopting Section 11(e).** The Court has a clean slate to write upon, for no case has heretofore considered the question, and no reported securities case has ever involved such a gargantuan award.

---

* This decision, which we opposed, is closely related to the present uncertainty over the degree to which actions brought under Rule 10b-5 and Section 14(e) require proof of fraud. To examine the question whether negligence alone is sufficient, the Supreme Court on April 14, 1975, agreed to review a decision of the Court of Appeals of the Seventh Circuit which held that an accountant could be held liable under Rule 10b-5 for negligence. *Hochfelder* v. *Ernst & Ernst,* 503 F.2d 1100 (7th Cir. 1974), *cert. granted,* CCH Fed. Sec. L. Rep. at p. 73,014.

** Reasonable reflection of the statutory intent would limit the liability of First Boston to no more than the application of the per share assessment found by the Court ($36.98) to the 111,628 shares of Piper which BPC acquired on its exchange offer.

B. The Injustice to All Defendants.

In Chris-Craft II, this Court on its own motion stated the applicable measure of damages precisely and concisely:

> "The measure of damages should be the reduction in the appraisal value of CCI's Piper holdings attributable to BPC's taking a majority position and reducing CCI to a minority position, and thus being able to compel a merger at any time." 480 F.2d at 380.

Instead of the formula the Court took pains to formulate and prescribe in Chris-Craft II, the Court has now said it meant not less than the difference between the cost CCI incurred in acquiring shares of Piper and the amount it might have sold those shares for in a hypothetical public offering at the end of January 1970, five months after September 5, 1969, the latter being the date all parties and both courts have fixed as the proper date for the determination of damages. Such a result could not have been anticipated from the language used in the prescription quoted from Chris-Craft II.

The combined effect of the Court's having first volunteered the precise measure of damages in Chris-Craft II and now not only reversing its field but also *fixing* the damages is to deprive defendants of any opportunity to brief and argue the question of what the measure of damages should be or to present evidence directed to the factual questions involved. The net result amounts to a violation of defendants' constitutional rights to due process of law.

C. The Lack of Findings Below.

The orderly processes of adjudication require findings by the District Court on the material disputed issues of fact. No amount of time or saving in judicial manpower can excuse the injustice done to defendants by the Court's abandoning after the trial its highly specific formula for damages, writing a new and different formula, and then trying the case itself on mere representations of CCI never tested in or accepted by the trial court.

The representations concerning the supposed need for a registration statement for CCI's sale of Piper shares and the assumed inability to make one effective in less than five months are vigorously and emphatically denied by defendants.

For this Court now to accept and act upon such cavalier statements in itself fixing a $35 million figure for damages is insupportable. The submission of written reports by the experts does not warrant such a departure from established judicial procedures. They testified orally on the subjects covered by their reports and were cross-examined by counsel and to a significant degree by the trial court itself, on the points it deemed relevant. Confidence in the judgment of an expert can come only from observing that cross-examination.*

---

* The cases cited by the Court do not support the propriety of its action in the instant case. In *Georgia-Pacific Corp.* v. *U.S. Plywood-Champion Papers Inc.*, 446 F.2d 295, 299 (2d Cir. 1971) the Court's determination of the damages at the appellate level was expressly based on "the willingness of the party ultimately paying the damages to have us dispose of the case." *Dopp* v. *Franklin National Bank*, 461 F.2d 873 (2d Cir. 1972), involved only a preliminary injunction based exclusively on affidavits and depositions without any evidentiary hearing. The other cited cases were neatly summarized and disposed of in one of the cited cases, *Traylor* v. *United States*, 396 F.2d 837 (6th Cir. 1968), as follows (p. 840):

> "In some exceptional cases, inadequate damages awarded by a court sitting without a jury have been increased by the Courts of Appeals, obviating the necessity for a remand (citations omitted); and even the more elusive assessment of pain and suffering has been increased where the '* * * unchallenged findings of the district court [were] sufficient***' (citation omitted). Those cases, however, were either actions for contract damages, which are capable of more precise evaluation from a bare record, (citations omitted) or cases, such as the *Thomas* case, where the District Court's opinion provided '* * * firm guidelines establishing the basic elements of the award***' (citation omitted). Here we do not have the benefit of the District Court's findings of fact or conclusions of law concerning the basic elements of damages or the amounts awarded for each element."

The Court states (p. 2852)*, "The ultimate determination of the value of CCI's holdings before and after BPC obtained control in the end would be made by us on the basis of essentially the same record now before us." This statement is in error. If defendants were to be afforded an opportunity to try the issue of damages on the formula now adopted by the Court, the record would be completely different from the one presented by the case as tried under its previous opinion.

Moreover, the panel decision states (p. 2855), "CCI's payments for Piper stock (averaging $64 per share) *included a substantial premium for the opportunity to compete for control. Defendants' violations deprived CCI of that opportunity.*" This statement itself suggests that Chris-Craft was entitled not to rescission damages, but to recovery of the premium it paid for the opportunity it was denied. Accepting this statement as true for present purposes, the Court should then remand the case for a determination of the amount of that premium. The trial court's findings and all the testimony of the experts presented on both sides suggest that it could not have exceeded $14 to $16 per share, since all fixed fair values for the shares *without regard to control premiums* in the general vicinity of $48 to $50 per share.

Indeed, if the 5% Judge Pollack found to be a fair premium for that opportunity is accepted—as it should be for it was supported by substantial evidence—application of that percentage to the $63.98 per share which the Court now says it considers to be the minimum "appraisal value" of the Piper shares would result in damages of about $3½ million, not $35 million.**

---

* Page references are to the Slip Opinion dated April 11, 1975.

** It should also be noted that the award of prejudgment interest is in the discretion of the *trial judge,* taking into account, among other things, *the sum involved.* See *Norte & Co.* v. *Huffines,* 416 F.2d 1189, 1191 (2d Cir. 1969), (opinion on rehearing), *cert. denied,* 397 U.S. 989 (1970). Would Judge Pollack have awarded prejudgment interest had he known the damages would be multiplied 15 times?

D. Errors of Law in the Formula Adopted.

The measure of damages adopted is not only wholly unwarranted by the facts but is also contrary to established principles of law. It (i) sweeps away any requirement that the defendants shall have caused the damages, contrary not only to the express provisions of Section 11(e) of the 1933 Act referred to above, but also to the express provisions of Section 28(a) of the 1934 Act and (ii) adopts an inappropriate rescission theory of damages while CCI continues to own the Piper shares, a result equally contrary to established principles of the securities laws.

In its damage formula as stated in the prior decision, the Court included the phrase "the reduction in value . . . *attributable to* BPC's taking a majority position and reducing CCI to a minority position." (emphasis added.)

In the instant decision the requirement that the damages chargeable to defendants be those "attributable to" their acts is cast aside in toto. The defendants cannot have caused the damages to CCI as now determined, for it is undeniable that, in using a hypothetical sale five months later to subtract from CCI's cost, the Court has included in the damages a great deal more than just that portion of its cost which was the "premium for the opportunity to compete for control." All witnesses agreed that the securities markets were in a precipitous decline between September 5, 1969, and the end of January 1970 for general economic reasons wholly unrelated to this case or any of its parties. The decline in the value of CCI's Piper holdings in that time period would have occurred even if it had acquired all the shares of Piper it wanted.

This is not a case, such as *Chasins* v. *Smith, Barney & Co.*, 438 F.2d 1167 (2d Cir. 1970), in which defendants were found to have improperly induced the complaining party to make an investment and are therefore said to be fairly held for the loss actually suffered on resale, even though general business and economic matters also contribute to the loss. Defendants did not induce CCI to invest in Piper. On the contrary, they strongly opposed CCI's acquiring

shares of Piper and the gravamen of CCI's complaint is that it was unable to acquire more!

In such a case as this, a rescission theory of damages, indemnifying CCI against a purely hypothetical loss "incurred" as a result of general market conditions, not any acts of defendants—while CCI continues to this very day to own the shares—is wholly inappropriate and patently unjust. See *Feit* v. *Leasco Data Processing Equipment Corp.*, 332 F. Supp. 544, 586-88 (E.D.N.Y. 1971), where the Court reduced the damages by the percentage decline in the Dow Jones average.

E. Summary.

The measure of First Boston's liability to CCI is a question of first impression having practical consequences far beyond this case.

Judge Medina observed in his monumental analysis of the American system of corporation finance some 20 years ago:

> "It would be difficult to exaggerate the importance of investment banking to the national economy. . . . [A]dequate financing . . . is the life blood without which many if not most . . . parts of the great machine of business would cease to function in a healthy, normal fashion."

United States v. *Morgan*, 118 F.Supp. 621, 635 (S.D.N.Y. 1953).

First Boston, which is one of the largest and most heavily capitalized investment banking firms, has a net capital of only $66.9 million, and the capital of most firms is considerably less. The imposition upon such firms of damages of the order of magnitude of those imposed by the panel for claims arising out of financial services, which may have been imperfectly performed in the hindsight view of the Court but which were based on advice of counsel and independent accountants as well as careful investment judgments and which were never even claimed to have been malevolently done, raises very seri-

ous questions as to the ability of investment bankers to continue to perform such services for any but the very largest corporations whose willingness and ability to indemnify them is unquestionable. The consequences of such a situation could only be contrary to the public interest.

As was said by Chief Judge Cardozo in a similar context, the "hazards of a business conducted" on terms of exposure to "liability in an indeterminate amount for an indeterminate time to an indeterminate class" are "so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences." *Ultramares Corp.* v. *Touche,* 255 N.Y. 170, 179-80 (1931).

This Court, because its jurisdiction covers the financial capital of the world, has a special responsibility in the fashioning of a coherent body of law carrying into effect the principles of the federal securities laws. The issues presented for rehearing are of exceptional importance to the Court's discharge of this responsibility and should be heard and determined by the Court in banc.

CONCLUSION

For the reasons stated above, this petition for rehearing, or rehearing in banc, should be granted.

Respectfully submitted,

SULLIVAN & CROMWELL
Attorneys for
The First Boston Corporation
48 Wall Street
New York, New York 10005
(212) 952-8100

ARTHUR H. DEAN
DAVID W. PECK
JOHN F. ARNING
CHARLES W. SULLIVAN
Of Counsel

LOUIS LOSS
Of Counsel

April 25, 1975

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

- x

CHRIS-CRAFT INDUSTRIES, INC., :

Plaintiff-Appellant-Cross-Appellee, :

-against- : Docket Nos. 74-2542 75-7003

PIPER AIRCRAFT CORPORATION, et al., :

Defendants-Appellees-Cross-Appellants. :

- x

STATE OF NEW YORK)
: SS.:
COUNTY OF NEW YORK)

GEORGE A. SCHOLZE, being duly sworn, deposes and says that he is an attorney associated with Sullivan & Cromwell, attorneys for The First Boston Corporation; that on the 25th day of April, 1975 he caused the within Petition for Rehearing and Notice of Motion and Amicus Curiae Brief to be served upon the following attorneys at the following addresses by having two true copies of the same delivered to each of the said attorneys at said addresses by leaving the same with a person in charge of said offices, as follows:

Paul, Weiss, Rifkind, Wharton & Garrison
345 Park Avenue
New York, N.Y. 10022

Webster Sheffield Fleischmann
Hitchcock & Brookfield
One Rockefeller Plaza
New York, N.Y.

Chadbourne Parke Whiteside & Wolff
30 Rockefeller Plaza
New York, N.Y.

George A. Schobe

Sworn to before me this
25th day of April, 1975

Eileen L. Franklyn
Notary Public

EILEEN L. FRANKLYN
NOTARY PUBLIC, State of New York
No. 31-1303130
Qualified in New York County
Commission Expires March 30, 1977